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Tuesday, January 09, 2007

Supreme Court says IP licensees can sue before infringing

In today's decision in *MedImmune v. Genentech*, the U.S. Supreme Court held that (possibly subject to a caveat described below) a patent licensee can sue to get out of the license without having to infringe the patent first. In other words, the licensee can sue without stopping the license payments. This sounds like some minor procedural point. It is a procedural point but it is hardly minor. It dramatically changes the risks of infringement and invalidity, and on whom those risks are placed, in a licensing relationship.

The Court's opinion today reverses the doctrine of the Federal Circuit, the normal appeals court for U.S. patents, that had held that there was no standing for a patent licensee to sue until it had actually infringed the patent or breached the contract. This meant that the licensee had to risk triple damages (for intentional infringement) and other potential problems in order to have a court determine whether the patent was valid or being infringed. This could be harsh, and it has long been argued that such consequences coerce licensees into continuing to pay license fees for products that it has discovered are not really covered by the patent.

Given the fuzziness of the "metes and bounds" of patents, this is a common occurrence. Sometimes the licensee's engineers come up with an alternative design that seems to avoid the patent, but the licensee is too scared of triple damages if the court decides otherwise and sticks with the patented product and paying the license fees. At other times new prior art is discovered or some other research uncovers the probable invalidity of the patent. But enough uncertainty remains that , given the threat of triple damages, the licensee just keeps paying the license fees.

A caveat is that the licensor may have to first "threaten" the licensee somehow that they will take action if the licensee doesn't make the expected payments or introduces a new product not covered by the license. In this case that "threat" took the form of an opinion letter from the licensor that the licensee's new product was covered by the old patent, and thus that the licensee had to pay license fees for the new product

Justice Scalia wrote the opinion for the eight justice majority. He argued that if the only difference between a justiciable controversy (i.e. a case where the plaintiff has standing under "case or controversy" clause of the U.S Constitution) and a non-justiciable one (i.e. no standing to sue) is that the plaintiff chose not to violate the disputed law, then the plaintiff still has standing:

> The plaintiff's own action (or inaction) in failing to violate the law eliminates the imminent threat of prosecution, but nonetheless does not eliminate Article III jurisdiction. For example, in *Terrace v. Thompson*, 263 U. S. 197 (1923), the State threatened the plaintiff with forfeiture of his farm, fines, and penalties if he entered into a lease with an alien in

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> violation of the State's anti-alien land law. Given this genuine threat of enforcement, we did not require, as a prerequisite to testing the validity of the law in a suit for injunction, that the plaintiff bet the farm, so to speak, by taking the violative action.

One of the main purposes of the Declaratory Judgments Act, under which such lawsuits are brought, is to avoid the necessity of committing an illegal act before the case can be brought to court:

> Likewise, in *Steffel v. Thompson*, 415 U. S. 452 (1974), we did not require the plaintiff to proceed to distribute handbills and risk actual prosecution before he could seek a declaratory judgment regarding the constitutionality of a state statute prohibiting such distribution. Id., at 458, 460. As then-Justice Rehnquist put it in his concurrence, "the declaratory judgment procedure is an alternative to pursuit of the arguably illegal activity." Id., at 480. In each of these cases, the plaintiff had eliminated the imminent threat of harm by simply not doing what he claimed the right to do (enter into a lease, or distribute handbills at the shopping center). That did not preclude subject matter jurisdiction because the threat-eliminating behavior was effectively coerced. See *Terrace*, supra, at 215. 216; Steffel, supra, at 459. The dilemma posed by that coercion "putting the challenger to the choice between abandoning his rights or risking prosecution" is "a dilemma that it was the very purpose of the Declaratory Judgment Act to ameliorate." *Abbott Laboratories v. Gardner*, 387 U. S. 136, 152 (1967).

Scalia, who is normally no fan of easy standing, extended this doctrine from disputes with the government to private disputes. For this he used as precedent *Altvater v. Freeman*:

> The Federal Circuit's *Gen-Probe* decision [the case in which the Federal Circuit established its doctrine which the Supreme Court today reversed] distinguished *Altvater* on the ground that it involved the compulsion of an injunction. But *Altvater* cannot be so readily dismissed. Never mind that the injunction had been privately obtained and was ultimately within the control of
> the patentees, who could permit its modification. More fundamentally, and contrary to the Federal Circuit's conclusion, *Altvater* did not say that the coercion dispositive of the case was governmental, but suggested just the opposite. The opinion acknowledged that the licensees had the option of stopping payments in defiance of the injunction, but explained that the consequence of doing so would be to risk "actual [and] treble damages in infringement suits" by the patentees. 319 U. S., at 365. It significantly did not mention the threat of prosecution for contempt, or any other sort of governmental sanction.

Scalia as usual got to the point:

> The rule that a plaintiff must destroy a large building, bet the farm, or(as here) risk treble damages and the loss of 80 percent of its business, before seeking a declaration of its actively contested legal rights finds no support in Article III.

Scalia rebutted the argument that under freedom of contract the parties had a right to, and had here, created an "insurance policy" immunizing the licensor from declaratory lawsuits:

> Promising to pay royalties on patents that have not been held invalid does not amount to a promise not to seek a holding

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of their invalidity.

The lessons of this case also apply to copyright and other kinds of IP, albeit in different ways. In copyright one can be exposed to criminal sanctions for infringement so there is an even stronger case for declaratory lawsuits.

The most interesting issue is to what extent IP licensors will be able to "contract around" this holding and thus still be able to immunize themselves from pre-infringement lawsuits. It's possible that IP licensors will still be able to prevent their licensees from suing with the proper contractual language. Licensees on the other hand may want to insist on language that preserves their rights to sue for declaratory judgments on whether the IP they are licensing is valid or on whether they are really infringing it with activities for which they wish to not pay license fees. If there's interest, I'll post in the future if I see good ideas for such language, and if I have some good ideas of my own I'll post those. This will be a big topic among IP license lawyers for the foreseeable future, as Scalia's opinion left a raft of issues wide open, including the issues about how such language would now be interpreted.

I will later update this post with links to the opinions (I have them via e-mail from Professor Hal Wegner).

UPDATE: Straight from the horse's mouth, here is the slip opinion.

Posted by Nick Szabo at 1:02 PM

3 comments:

A said...

Huge news. I'm going to need some time to digest this one; still been trying to learn the facts of the case. (Looking forward to the links -- the Reuters and AP reports of the SCOTUSBlog aren't doing it for me, unsurprisingly.)

This may be a silly question, but what does the court mean by saying that the injuction had been "privately obtained"? I assume that means contracted-for rather than arbitrated or something of that nature, but "injunction" seems inappropriate somehow.

3:33 PM

Anonymous said...

The primary purpose and outcome of this decision is to employ lawyers.

Nothing less, nothing more...

What the hell good is patent law if clients are scared into paying the patent holder instead of patent lawyers?

All verbage that surrounds the decision window dressing.

6:57 AM

A said...

It seems to me that allowing for declaratory judgments before infringing -- rather than suing for massive settlements after the fact -- isn't exactly a recipe for huge lawyer profits, so if they're searching for windfalls, they might want to rethink this one.

Just my opinion.

1:43 PM

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